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No. 86-781

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

KANSAS GAS AND ELECTRIC COMPANY,
Appellant,

v.

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS,
Appellee.

On Appeal from the Supreme Court of Kansas

APPELLANT'S SUPPLEMENTAL REPLY TO MOTION TO DISMISS FOR LACK OF CASE OR CONTROVERSY

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On April 13, 1987, the State Corporation Commission of the State of Kansas (KCC) filed a motion to dismiss this appeal for mootness or lack of a case or controversy. The KCC argued in its motion that a rate order issued March 11, 1987 (1987 Order) rendered this case moot because the new order granted KG&E virtually all the relief requested. On April 23, 1987, Kansas Gas and Electric Company (KG&E) filed its reply to that motion arguing that KG&E continues to suffer injury. Recent events of May 6, 1987, may have changed the assumptions on which the 1987 Order and the KCC's motion are based. These events, described more fully below, may result in severe injury to KG&E's financial health. These events underscore the need for this Court to deny the KCC's motion to dismiss.

BACKGROUND

As a publicly held company, KG&E is subject to the financial accounting and reporting standards established by the Financial Accounting Standards Board (FASB):

> Since 1973, the Financial Accounting Standards Board has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards govern the preparation of financial reports. They are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101) and the American Institute of Certified Public Accountants (Rule 203, Rules of Conduct).
>
> The SEC has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest.

Facts about FASB 1987 at 1 (Jan. 1987).

In December 1982, FASB issued Statement of Financial Accounting Standards No. 71 which provides guidance in preparing general purpose financial statements for most public utilities. Notably, in defined circumstances, Statement 71 permits net income to be increased by a non-cash allowance for funds used during construction, consisting of an equity component and a debt component. Statement 71, however, did not prescribe the accounting for non-cash accruals of income associated with three types of events that recently have occurred in the electric utility industry—phase-in plans, abandonments, and disallowances of costs of newly completed plants.

On December 19, 1985, FASB issued an exposure draft of a proposed statement which would prescribe accounting for phase-in plans, abandonments, and disallowances. After an extended period for comments and hearings, FASB in December 1986, issued Statement of Financial Accounting Standards No. 90 which prescribes accounting for abandonments and disallowances. Statement 90 does not treat accounting for phase-in plans. On January 20, 1987, FASB indicated its intention to issue a new exposure draft concerning accounting for phase-in plans because ". . . it could not continue to support accounting for phase-in plans . . . similar to that proposed in the December 1985 exposure draft. . . ." Financial Accounting Series No. 041 at 7 (January 20, 1987).

Subsequent to January 20, 1987, FASB indicated that accounting for phase-in plans would not be reexposed. Instead, FASB indicated that it would issue a statement based on the December 1985 exposure draft. At a public meeting on May 6, 1987, FASB discussed and indicated its intention to approve such a statement. Based on discussions by FASB at its May 6 meeting, the expected statement would adversely affect certain accounting treatment authorized by the Kansas Corporation Commission (KCC), in the 1987 Order approving KG&E's rate stabilization plan. (See App. to KCC's motion to dismiss, A1-A37). The 1987 Order is the sole basis for the KCC's assertion that this appeal should be dismissed.

ARGUMENT

KG&E's rate stabilization plan depends upon the continued viability of the accounting treatment which the 1987 Order authorizes in its ordering paragraphs 7, 8, 9, and 10, as follows:

> 7. The authority granted to KG&E in Docket No. 149,109-U to accelerate to eight years the amortization of construction related tax credits, as more fully described in that Docket, is reaffirmed.

8. KG&E is permitted to accrue carrying charges on the portion of Wolf Creek which the Commission finds constitutes excess physical capacity. Such accrual will be at KG&E's before tax (gross) cost of debt and preferred stock adjusted annually and shall be applied to KG&E's investment of $2,376 per KWH.

9. KG&E is permitted to accrue deferred phase-in revenues at a before tax (gross) rate until the delayed third rate increase becomes effective on January 1, 1989. KG&E is also permitted to accrue carrying charges on these accumulated revenues until the delayed fourth rate increase becomes effective on January, 1992. The carrying charges are to be based on a 15.5 percent cost of equity and KG&E's actual cost of debt and preferred stock adjusted annually. These carrying charges are to be compounded semi-annually. KG&E is not permitted to accrue deferred phase-in revenue related to the incremental impact of Ripley's retirement.

10. KG&E is permitted to cease accrual of all deferrals and carrying charges on December 31, 1991, and thereafter amortize the deferrals and carrying charges on a sinking fund basis over Wolf Creek's remaining depreciable life.

(*Id.* at A35-A36).

At its May 6 meeting, KG&E understands [1] that FASB indicated its intention to approve a statement which would prescribe accounting for phase-in plans. Based on FASB's May 6th discussion, it appears that such a state-

[1] FASB has not issued a written account of its deliberations at the May 6 meeting. The meeting was public and was attended by a representative of Deloitte Haskins & Sells, KG&E's independent auditor. KG&E's representations concerning the May 6 FASB meeting are based upon information provided to KG&E by Deloitte Haskins & Sells. Given the pendency of the KCC's motion to dismiss, KG&E could not delay this supplemental reply until receipt of an official FASB communication concerning the May 6 meeting, let alone wait for FASB's issuance of a statement which prescribes accounting for phase-in plans.

ment will permit non-cash accruals of income associated with phase-in plans only if a phase-in plan permits complete recovery of all such accruals within 10 years. The 1987 Order authorized KG&E to recover non-cash accruals of income, associated with KG&E's rate stabilization plan, on a sinking fund basis over 33 years, from 1992 through 2025. (*Id.* at A35). Such recovery would not satisfy FASB's 10 year limit. A similar problem exists for the accelerated amortization of tax credits permitted in ordering paragraph 7 of the 1987 Order. (*Id.*) Finally, KG&E understands that FASB will apply the expected statement on a retroactive basis. This means that non-cash income associated with the rate phase-in for Wolf Creek which KG&E has already booked under the 1987 Order, as well as under the original September 1985 Wolf Creek Order (the subject of this appeal), would have to be written-off against retained earnings.

Of course, the exact impact on KG&E's financial health of the expected statement cannot be determined until the statement is approved and issued. Although the statement would have no impact on KG&E's cash flow, it is possible that for a period of time neither current nor retained earnings would be sufficient to cover any dividends. In such circumstances, dividends paid would constitute a return of capital—a partial liquidation of the company—rather than a payment of earnings.[2] Therefore, the 1987 Order, contrary to the KCC's assertion in its motion to dismiss, does not provide the relief requested in this appeal. A situation that leaves KG&E with no current or retained earnings cannot possibly satisfy the requirement established in *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679 (1923) of a return that assures confidence in

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[2] KG&E's rate stabilization plan may be modified in the future by the KCC to reduce or eliminate the otherwise adverse impact of the statement.

the financial soundness of the utility (see Brief For Appellant Kansas Gas and Electric Company at 16-25).

The events described in this supplemental reply underscore the central point of KG&E's April 23 reply. The 1987 Order issued by the KCC does not moot the present controversy because the 1987 Order does not provide KG&E adequate relief.

For the reasons stated herein and in KG&E's April 23 reply, the Court should deny the KCC's motion to dismiss, and should hear oral argument and decide this case on its merits.

Respectfully submitted,

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